

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ALABAMA
SOUTHERN DIVISION

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U.S. DISTRICT COURT
N.D. OF ALABAMA

UNITED STATES OF AMERICA

v.

RICHARD E. BOTTS,
Defendant

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RULE 11(f) FACTUAL BASIS FOR GUILTY PLEA

COMES NOW the United States of America through its undersigned counsel, for the purpose of satisfying the requirements of Federal Rule of Criminal Procedure 11(f), submits the following Factual Basis in support of the guilty plea of **RICHARD E. BOTTS**:

HealthSouth

1. HealthSouth Corporation (“HealthSouth”) was formed in 1984. HealthSouth is the nation’s largest provider of outpatient surgery, diagnostic imaging, and rehabilitative health care services with approximately 1800 locations in all fifty states, the District of Columbia and abroad. Since approximately 1988 until March **2003**, HealthSouth’s common stock was listed on the New York Stock Exchange. Many of its executives, including its then Chief Executive Officer (the “CEO), either owned shares in HealthSouth, or owned options to such shares. The CEO, and others, were also compensated in **part** by bonuses. The bonuses depended on how well HealthSouth performed financially.

2. HealthSouth, like other companies whose shares were publically traded, generated and publicized earnings expectations. Stock market analysts did the same. Whether a company met, exceeded, or failed to meet such expectations, was often a factor that influenced the price of its shares.

3. Since in or about 1986, when it made its Initial Public Offering (IPO), HealthSouth has been an issuer of a class of securities registered under Section 12 of the Securities Exchange Act of 1934, required to file quarterly and annual statements (Forms 10-Q and Forms 10-K) under said Act with the Securities Exchange Commission ("SEC"). These statements reported HealthSouth's earnings, as well as the value of its assets and liabilities. These reports were available to the public, which used them to determine whether HealthSouth met the aforesaid expectations.

4. Under provisions of the federal securities laws and the regulations promulgated thereunder, HealthSouth was also required to make and keep books, records, and accounts that accurately and fairly reflected the transactions and dispositions of the company's assets; and to devise and maintain a system of internal accounting controls sufficient to provide - (i) reasonable assurances that the company's transactions were recorded as necessary to permit preparation of financial statements in conformity with generally accepted accounting principles ("GAAP") and other criteria applicable to such statements and to maintain the accountability of assets; and (ii) reasonable assurances that the recorded accountability for assets was compared with the existing assets at reasonable intervals and appropriate action was taken with respect to any differences.

The Conspiracy.

5. Beginning at least in **1996**, the CEO, other Senior Officers and members of HealthSouth's accounting staff including, from time to time, Michael Martin, William Owens, Aaron Beam, Malcolm McVay, Weston Smith, Emery ~~Harris~~, Ken Livesay, Cathy Edwards, Virginia Valentine, Kay Morgan, Angela Ayres, Jason Brown and others, engaged in a conspiracy and scheme and artifice to, among other objectives, defraud investors by artificially inflating HealthSouth's earnings and earnings per share, make false entries in HealthSouth's books and records, file false statements with the SEC, and commit mail and wire fraud.

6. HealthSouth's CEO and other Senior Officers reviewed monthly and quarterly preliminary reports showing HealthSouth's true and actual financial results, which usually showed that HealthSouth had not met earnings per share expectations. At the direction of the **CEO**, these Senior Officers would then direct HealthSouth's accounting staff to manipulate HealthSouth's **books**, accounts and records to ensure that HealthSouth's earnings per share number met or exceeded those expectations.

7. Methods to increase earnings included making entries to reduced offsets against revenues or to reduce expenses. Corresponding fraudulent entries were made to increase assets and decrease liabilities on HealthSouth's Balance Sheet. Such entries were made to, among other accounts, HealthSouth's (1) Property, Plant and Equipment ("PP&E") accounts; (2) cash accounts; (3) inventory accounts; (4) intangible asset (goodwill) accounts; and (5) investment portfolio.

8. These entries caused the quarterly and annual financial statements filed with the SEC for the years from before **1996** through **2002**, **that** is, Forms 10-Q and Forms **10-K**, to be

materially false. The cumulative overstatement of assets summed more than a billion dollars. Some of these financial statements were transmitted electronically from Birmingham, Alabama to Washington, D.C., to be filed with the SEC.

9. The CEO and other conspirators benefitted from the conspiracy by receiving salaries, bonuses, and an increased value in their stock and stock options. The investing public suffered to the extent they paid for shares whose value was inflated by the aforesaid conspiracy.

The Defendant

10. Defendant **RICHARDE E. BOTTS** was employed at HealthSouth since approximately 1988 in the tax department. In May 1998, defendant **BOTTS** was promoted to the position of Senior Vice President for Tax. In this position, defendant **BOTTS** headed HealthSouth's tax department which included as many as sixteen employees. As Senior Vice President for Tax, defendant **BOTTS**' responsibilities included reviewing, signing and maintaining HealthSouth's federal tax returns, tax returns for all fifty states, the District of Columbia and Puerto Rico, and providing information to taxing authorities who sought to ensure HealthSouth's compliance with federal and state laws and regulations.

11. In the course of his employment at HealthSouth, defendant **BOTTS** would and did become aware of the HealthSouth's earnings shortfalls and the potential adverse effect on HealthSouth's stock price if these shortfalls were disclosed to the public.

12. In or about the fall of 2000, defendant **BOTTS** learned of, and knowingly and voluntarily joined in, the above-described conspiracy and scheme and artifice. **This** occurred in the course of a county tangible personal property tax audit when defendant **BOTTS** learned that bogus and fictitious assets, for which there **was** no legitimate back-up documentation, had been

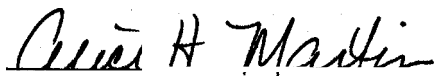
created and placed on the books and records of HealthSouth. Once learning of the scheme, defendant **BOTTS** knew that the fictitious assets which had been placed on HealthSouth's general ledger would affect the amount of the depreciation which would need to be reported to the **tax** authorities. Members of HealthSouth's accounting **staff** provided defendant **BOTTS** with false depreciation schedules which were tied to and included the fictitious assets on the general ledger. Defendant **BOTTS** then provided the false depreciation schedules to tax officials, knowing that his action would prevent discovery of the bogus assets and the scheme to inflate HealthSouth's earnings.

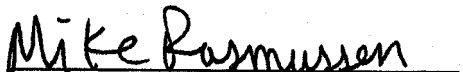
13. Defendant **BOTTS** thereafter prepared, signed and submitted, and caused to be prepared, signed and submitted, to other local and state **tax** authorities tax returns for HealthSouth which contained false information including, but not limited to, false information about HealthSouth's taxable income, depreciation deductions and assets.


14. In addition, in 2001 and 2002 defendant **BOTTS** knowingly and wilfully prepared, signed and submitted, and caused to be prepared, signed and submitted, to the **U.S.** Internal Revenue Service (IRS) consolidated **U.S.** Corporation Income Tax Returns for HealthSouth which he knew to contain materially false information and representations including, but not limited to, false information about HealthSouth's taxable income, depreciation deductions and assets. These false documents included HealthSouth's consolidated U.S. Corporation Income Tax Returns for fiscal year 2000 dated September 15, 2001 and HealthSouth's consolidated **U.S.** Corporation Income Tax Returns for fiscal year 2001 dated September 16, 2002.


15. Defendant **BOTTS** sent and delivered and caused to be sent and delivered to the **IRS** the HealthSouth U.S. Corporation Income ~~Tax~~ Returns via the U.S. Postal Service knowing his actions would help prevent discovery of, and thereby further, the scheme to inflate HealthSouth's publically reported earnings.

16. Defendant **BOTTS** and others also maintained in the files, books and records of HealthSouth the above-described state and federal tax returns which they knew to contain false information.


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